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In the Supreme Court of the United States

OCTOBER TERM, 1977

BRITISH AMERICAN COMMODITY OPTIONS CORP. and LLOYD, CARR & CO., PETITIONERS

v.

WILLIAM T. BAGLEY, CHAIRMAN OF THE COMMODITY FUTURES TRADING COMMISSION, ET AL.

NATIONAL ASSOCIATION OF COMMODITY OPTION DEALERS, ET AL., PETITIONERS

v.

COMMODITY FUTURES TRADING COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 29a-52a)[1] is reported at 552 F.2d 482. The opinion of the district court (Pet. App. 1a-26a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on April 4, 1977. Petitions for rehearing were denied on June 6, 1977 (Pet. App. 53a-54a). The petition in No. 77-96 was filed on July 15, 1977, and the petition in No. 77-204 was filed on August 5, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Commodity Futures Trading Commission has the authority to require sellers of options on commodities to place 90 percent of the price paid by each customer into a separate fund until the option is exercised or expires.

2. Whether the Commission properly exercised its rulemaking authority to require that all option dealers and their employees be registered by January 17, 1977.

3. Whether the Commission gave adequate notice of and afforded adequate opportunity to comment on its proposed rules.

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[1] "Pet. App." refers to the appendix in No. 77-96.

STATUTES AND REGULATIONS INVOLVED

1. Section 4c(b) of the Commodity Exchange Act, as added by the Commodity Futures Trading Commission Act of 1974, 88 Stat. 1412, 7 U.S.C. (Supp. V) 6c(b), provides:

> No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this chapter, but not specifically set forth in section 2 of this title, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: *Provided*, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: *And provided further*, That the Commission may set different terms and conditions for different markets.

2. Section 8a(5) of the Act, as added, 49 Stat. 1501, and amended, 7 U.S.C. (Supp. V) 12a(5), provides that:

> The Commission is authorized—
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> * * * * *
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> to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter; * * *.

3. Section 15 of the Act, as added, 88 Stat. 1395, 7 U.S.C. (Supp. V) 19, provides:

> The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this chapter, as well as the policies and purposes of this chapter, in issuing any order or adopting any Commission rule or regulation, or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 21 of this title.

4. The pertinent portions of the Administrative Procedure Act, 5 U.S.C. 553(d) and 706, are set out at Pet. App. 57a-58a.

5. The pertinent portions of Regulation 32 of the Commodity Futures Trading Commission, 17 C.F.R. Part 32, are set out at Pet. App. 60a-65a.

STATEMENT

1. Until 1974 Section 4c(B) of the Commodity Exchange Act, 7 U.S.C. (1970 ed.) 6c(B), prohibited

trading in options to purchase certain specifically-enumerated agricultural commodities.[2] See Section 2(a), 7 U.S.C. (1970 ed.) 2. Option transactions in other commodities were unregulated, however, and fraudulent and unsound business practices developed. Option firms—which, historically, have relied heavily upon customer funds to carry on their operations—frequently became insolvent or unable to perform their obligations, causing substantial losses to numerous investors.[3]

In 1974 Congress amended the Commodity Exchange Act, extending coverage to almost all commodities and creating the Commodity Futures Trading Commission as an independent agency to administer and enforce the Act's provisions. Although Congress continued the ban on options on specific agricultural commodities contained in Section 4c(a)(B) of the Act, as amended, 7 U.S.C. (Supp. V) 6c(a)(B), it added Section 4c(b) to the Act to provide with respect to all newly regulated commodities that "[n]o

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[2] "A 'commodity option' is a contractual right to buy, or sell, a commodity or commodity future by some specific date at a specified, fixed price, known as the 'striking price.' A contract entitling its owner to purchase the commodity is known as a 'call,' and a contract entitling its owner to sell is called a 'put'" (Pet. App. 33a).

[3] H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 37-38 (1974). See also Hearings on H.R. 11955 (Commodity Futures Trading Commission Act of 1974) before the House Committee on Agriculture, 93d Cong., 2d Sess. 181-182, 194-196 (1974); Hearings on S. 2485, S. 2578, S. 2837 and H.R. 13113 (Commodity Futures Trading Commission Act) before the Senate Committee on Agriculture and Forestry, 93d Cong., 2d Sess., Pt. 1, 224-225; Pt. 3, 830-835 (1974).

person shall offer to enter into, enter into, or confirm the execution of" any option contrary to any rule established by the Commission. The Commission, pursuant to its rulemaking authority under Section 8a(5) of the Act, extensively studied the offer and sale of commodity options and adopted a series of interim rules (17 C.F.R. Part 32) as the first phase of a comprehensive program intended effectively to regulate commodity option transactions in the United States (41 Fed. Reg. 51808).

Petitioners are firms that solicit public investors to purchase commodity options traded on exchanges in London, England, and a trade association of which those firms are members. They challenge the Commission's interim regulations, which require, among other things: (1) that persons proposing to engage in the offer and sale of commodity options to the public register with the Commission as futures commission merchants (17 C.F.R. 32.3);[4] (2) that option sellers disclose salient facts to customers concerning option transactions (17 C.F.R. 32.5); (3) that option sellers

[4] The Act requires several classes of commodity industry professionals to register with the Commission before doing business. Among those are "futures commission merchants," a term that includes (Section 2(a), 7 U.S.C. (Supp. V) 2), "individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."

segregate funds received from a customer until all obligations to the customer under the option have been performed (17 C.F.R. 32.6); (4) that sellers keep appropriate books and records (17 C.F.R. 32.7); (5) that sellers obey antifraud provisions (17 C.F.R. 32.9); and (6) that sellers maintain a specified minimum financial position (17 C.F.R. 1.17).

2. Among the most important of the Commission's interim rules is the requirement that any firm selling commodity options in the United States must treat 90 percent of the payment received from each customer "as belonging to such option customer until expiration of the term of the option or, if the option customer exercises the option, until all rights of the option customer under the commodity option have been fulfilled" (17 C.F.R. 32.6). The firm must segregate these customer funds in an account maintained in the United States that is separate from any of its own. Consequently, the firm must advance its own or borrowed funds to purchase the option from the option writer or grantor.

This "segregation" requirement addresses the most serious of the adverse consequences purchasers had suffered in the past—loss of the purchase price without being able to exercise an option. If an option dealer should become unable or unwilling to exercise an option on behalf of a customer (because of bankruptcy or any other reason), the customer would be in a position to recoup a substantial portion of the purchase price, even though he may be deprived of the bargained-for opportunity to exercise his option and

profit from favorable changes in the market (41 Fed. Reg. 51809, 51812-51813).

3. The district court upheld all of the provisions of the regulations except the segregation requirement, which it enjoined. On cross-appeals, the court of appeals upheld the regulations without exception.

The court of appeals first dealt with petitioners' procedural arguments. It observed (Pet. App. 41a) that the Commission published notice in October 1975 of its plan to promulgate regulations, released a specific proposal in February 1976, and held oral hearings in March 1976. The Commission then proposed a revised set of regulations in October 1976 and accepted further comments, and it did not issue the final regulations until November 24, 1976. The court of appeals held that this sequence gave petitioners ample opportunity to comment upon the Commission's proposals, and that there was no need to hold a second oral hearing after the October 1976 publication (*id.* at 40a-43a).

The court concluded that the segregation requirement is consistent with the Act. It pointed out that abuses have plagued the option business and that the segregation provision would help to protect customers from similar abuses in the future (Pet. App. 43a-44a). It explained that "stringent controls on the use of customers' money are particularly sensible in an industry, such as commodity options trading, that attracts some thinly capitalized firms. In the absence of such protection, a need for capital might prod a dealer into overdependence on customers' money to

finance general operations" (*id.* at 44a). The court concluded that "the requirement is not unreasonable even if it threatens to restrict participation in the industry to soundly capitalized firms" (*id.* at 45a, footnote omitted).

The court also held (Pet. App. 46a-48a) that the Commission was entitled to require that all dealers and employees register by January 17, 1977. It noted that there was adequate time between November 24, 1976, when the final regulations were promulgated, and January 17, 1977, within which to complete the registration process, and it concluded that petitioners and their employees were not entitled to wait until late December 1976 (when the district court upheld the regulations) before filing for registration and then to complain that the Commission could not process their applications in time.[5]

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[5] The court of appeals stayed its mandate pending this Court's disposition of any petitions for a writ of certiorari. It required petitioners to post bonds ranging to $250,000. The district court's injunction against the segregation regulation therefore remains in effect. The court of appeals also granted a motion by four additional firms to intervene in the appeal, and it relieved those firms of the obligation to segregate customer funds. These firms were required to post bonds ranging from $4,000 to $70,000. On August 8, 1977, Mr. Justice Marshall declined to vacate the stay of mandate.

Since then seven other option firms, claiming unfairness in having to obey a segregation requirement not imposed upon the parties to the instant case, have obtained orders enjoining the Commission from enforcing the segregation regulation. *Frankland Commodities Corp.* v. *Commodity Futures Trading Commission,* N.D. Ga., No. C-77-643A, decided May 12, 1977 (preliminary injunction denied; injunction pending appeal

ARGUMENT

1. The decision of the court of appeals is correct. It does not conflict with any decision of this Court, and, because it resolved several questions of first impression under a new statute, it did not create any conflict among the courts of appeals. Petitioners contend that this Court should grant review because the Commission's regulations threaten to put almost all commodity option dealers out of business. But rou-

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granted); *Dorchester Commodities Corp.* v. *Commodity Futures Trading Commission*, S.D. N.Y., 77 Civ. No. 3958, decided August 31, 1977 (preliminary injunction; two firms); *Neuberger Securities Corp.* v. *Commodity Futures Trading Commission*, S.D. N.Y., 77 Civ. No. 3048, decided September 14, 1977 (preliminary injunction); *Transocean Commodity Ltd.* v. *Commodity Futures Trading Commission*, S.D. N.Y., 77 Civ. No. 4060, decided September 14, 1977 (preliminary injunction); *London Commodity Options, Ltd.* v. *United States*, D. Utah. No. C-77-0293, decided September 16, 1977 (preliminary injunction); *Murlas Brothers Commodities, Inc.* v. *Commodity Futures Trading Commission*, D.D.C., No. C.A. 77-1473, decided September 19, 1977 (preliminary injunction). These firms have posted bonds ranging from $5,000 to $100,000. Three other firms have been denied relief. *First New York Investors Corp.* v. *Commodity Futures Trading Commission*, D. N.J., No. 77-0797, decided April 27, 1977; *Donney Securities Ltd.* v. *Commodity Futures Trading Commission*, S.D. N.Y., No. 77 Civ. 4620, decided September 26, 1977; *Barclay Commodities Corp.* v. *Commodity Futures Trading Commission*, E.D. Ill., No. 77 Civ. 3197, decided September 29, 1977.

At the time the petition was filed in No. 77-204, approximately 49 of the approximately 60 firms selling options thus were required to obey the segregation requirement. Routine Commission inspections of 14 options dealers showed that 12 of them were substantially in compliance with the segregation requirements at the time of the inspections.

tine Commission inspections of 14 of the approximately 60 firms selling options have established that 12 of these 14 were complying substantially with the regulations, and the Commission expects that other dealers are doing so as well.[6] Petitioners' predictions of industry-wide financial collapse therefore are unfounded.

Moreover, although the issues raised by this case may be important to petitioners, they do not involve novel legal questions or matters of significant public importance. Congress contemplated in the Act that the Commission could bring all option selling and trading to a halt if it should conclude that such a step was necessary (see Section 4c(b)). Petitioners emphasize that the Commission is a new agency and that the regulations impose new requirements in a previously unregulated activity. But these contentions do not establish that any of the particular issues petitioners present requires review by this Court.[7]

The Commission continues to study whether *any* commodity option activities are in the public interest. The Commission has been willing to allow option trading pending the completion of this study, but

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[6] See note 5, *supra*. See also page 15, *infra*.

[7] In denying the Commission's application to vacate the court of appeals' stay of mandate, Mr. Justice Marshall observed (slip op. 6) that the "question of whether [the segregation] requirement is arbitrary and capricious is rather fact-intensive, and is thus the type of matter that is normally appropriate for final resolution by the lower courts * * *."

only if adequate customer safeguards may be enforced (41 Fed. Reg. 44560). The sale of commodity options in the United States continues to be plagued by fraudulent and other unlawful practices.[8]

[8] Petitioners Lloyd, Carr & Co., British American Commodity Options Corp., and First Commodity Corp. of Boston, Inc. have all been the subjects of adverse enforcement action by the Commission.

The Commission has found Lloyd, Carr & Co. to have willfully violated the registration and recordkeeping provisions of the Commission's rules since January of this year. On that basis the Commission denied Lloyd, Carr's application for registration and ordered it to cease and desist from future violations. *In the Matter of James A. Carr and Charles P. LeMieux, III, d/b/a Lloyd, Carr & Co.*, Docket No. 77-6, petition for review pending, C.A. 2, No. 77-4146. In addition, an action has been instituted against Lloyd, Carr in the United States District Court for the District of Massachusetts, in which the Commission seeks to enjoin future violations. *Commodity Futures Trading Commission* v. *Lloyd Carr & Co.*, 77 Civ. 371-T.

On September 7, 1977, petitioner British American Commodity Options Corp. was enjoined from future violations of commodity trading advisor registration requirements in connection with its commodity option activities. See *Commodity Futures Trading Commission* v. *British American Commodity Options Corp.*, C.A. 2, No. 77-6002, decided August 3, 1977, reversing 422 F. Supp. 662 (S.D. N.Y.). In a pending administrative proceeding against British American, an Administrative Law Judge filed a recommended decision on June 11, 1977, finding a broad pattern of fraudulent option sales activities. *In the Matter of British American Commodity Options Corp.*, Docket Nos. 76-15, 77-3. In addition, an action has been instituted in the United States District Court for the Southern District of New York in which the Commission seeks to enjoin future violations of registration, bookkeeping and antifraud provisions of the Commission's regulations by British American. *Commodity Futures Trading Commission* v. *British American Commodity Options Corp.*, S.D. N.Y., No. 77 Civ. 1822.

On November 11, 1976, First Commodity Corp. of Boston, without admitting or denying the allegations of the Commission's complaint, consented to the entry of a final judgment permanently enjoining it from engaging in acts and practices in violation of the Act including, among others, antifraud provisions, book and recordkeeping provisions, and minimum financial requirements. *Commodity Futures Trading Commission* v. *First Commodity Corp. of Boston*, D. Mass., No. 76-4051-M.

The rules petitioners ask this Court to review are only the first stage of a comprehensive regulatory scheme; they have been proposed and adopted as temporary measures.

The Commission has already solicited and obtained public comment on proposals to amend and supplement the existing regulations to implement a rigidly controlled three-year pilot program of options trading on domestic commodity exchanges. 42 Fed. Reg. 18246 (April 5, 1977). As a result of comments from interested members of the public, revised proposals will be published shortly to solicit additional public comment. These new proposals, if adopted, would change many of the existing provisions—the present segregation rule in particular would be amended to relieve an option dealer from maintaining funds in a separate account during the entire term of an option if it should meet certain other requirements that would equally protect its customers' interests. We therefore believe that review by this Court of the present case would be premature.

2. There is nothing unusual about the interim rules the Commission adopted. Registration, record-keeping, minimum financial and antifraud provisions are all a part of the basic pattern of the Commodity Exchange Act,[9] and they have counterparts in the federal securities laws.[10] Segregation of customer funds, in particular, has been a part of the Commodity Exchange Act since it was amended in 1936. Under Section 4d(2) of the Act, 7 U.S.C. (Supp. V) 6d(2), upon which the segregation requirement of 17 C.F.R. 32.6 was patterned,[11] funds advanced by commodity futures customers have always been required to be segregated by futures commission merchants.[12] Even when segregation is not required, firms may advance funds (make "margin" sales) on behalf of clients.

Petitioners' suggestion that credit is unavailable to option dealers thus is unsupported by the experience of the commodities and securities industries, in which dealers historically have secured funds to loan

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[9] See Sections 4d to 4g, 4k, 4m, 4n, 7 U.S.C. (Supp. V) 6d to 6g, 6k, 6m, 6n.

[10] See the Securities Act of 1933, 48 Stat. 78, 82, 84, as amended, 15 U.S.C. 77f, 77k, and 77q; the Securities Exchange Act of 1934, 48 Stat. 895, 897, as amended, 15 U.S.C. 78o, 78q and 78r; the Investment Advisers Act of 1940, 50 Stat. 850, as amended, 15 U.S.C. 80b-3.

[11] 41 Fed. Reg. 44564.

[12] Section 4d(2) provides that a futures commission merchant "shall * * * treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the [futures] trades or contracts of any customer of such person * * * as belonging to such customer."

to customers in connection with their dealings.[13] Petitioners' suggestion also is not supported by experience of other option dealers. The four firms that intervened below (see note 5, *supra*) were in "full compliance" with the regulations on July 5, 1977, according to an affidavit filed on their behalf in the court of appeals by counsel for petitioners in No. 77-204.[14] Nine other option firms have recently indicated to various courts that they have been segregating customer funds in accordance with the rule and, for that reason, have suffered a competitive disadvantage when compared with the petitioners.[15] Inspections by the Commission show that other dealers have complied with the segregation requirement.[16]

Each firm will earn interest on funds required to be segregated, and the interest will cover most of the cost of borrowing to advance funds to purchase the options.[17] Perhaps some dealers would not be

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[13] The statutory definition of a "futures commission merchant" explicitly contemplates the extension of credit for customers' accounts (see note 4, *supra*). Similarly, it is an everyday practice for securities brokers to advance their own or borrowed funds to buy securities on margin accounts for customers. See Regulation T of the Federal Reserve Board, 12 C.F.R. Part 220.

[14] Affidavit of Leonard R. Goldstein in Support of Motion to Intervene, dated July 5, 1977.

[15] See note 5, *supra*. A tenth firm, Dorchester Commodities Corp., also so indicated; testimony at the hearing was to the contrary, however.

[16] *Ibid.*

[17] Petitioners state (Pet. No. 77-96, p. 22) that British American Commodity Options Corp. has a net after-tax profit of $82.66 on a typical option transaction in which a customer

able to comply with the segregation requirement, but this would be a commentary on their own financial weakness, not evidence of any defect in the rule. As the court of appeals observed (Pet. App. 44a), "the very point plaintiffs raise to challenge the wisdom of requiring domestic segregation—their financial vulnerability—argues strongly for the requirement." [18]

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pays a purchase price of $2,250. Regulation 32.6 would require a firm to segregate $2,025—90 percent of the $2,250 purchase price. If British American were to borrow this amount for a six-month option transaction, and were required to pay interest at a rate of 8½ percent per year (a rate petitioners suggested in the court below), the interest expense would be $86.07 for the six-month period. At the same time, however, the segregated fund of $2,025 may be placed in an interest-bearing account, and the option firm would be entitled to retain the interest that account earns. 17 C.F.R. 32.6(e). At six percent interest, the account would earn $60.75 in six months. Thus, the net cost of segregating would be $25.32 for an option costing $2,250. Even if none of the cost were passed on to the customer, British American still would have a net profit of $57.34 after payment of all sales commissions, executive salaries and other expenses.

[18] Petitioners contend that the segregation requirement is unnecessary because they meet the net capital requirements of 17 C.F.R. 1.17. But segregation and net capital rules are complementary, and the net capital rules have been structured in their present form only because they are augmented by the segregation rule. The Commission at one time considered setting minimum net capital so high that segregation would be unnecessary (see note 30, *infra*), but it decided against such a course because, by preventing borrowing to cover option costs, the rule would exclude many more firms than any segregation requirements. Petitioners cannot properly seize upon the fact that they meet the minimum capital requirements—

Regulations that establish standards for participation in a regulated industry necessarily exclude some firms that cannot or will not comply. But that is the purpose of the regulations, which protect investors by excluding firms that do not offer sufficient guarantees of investors' interests. Financially unstable firms pose substantial risks for investors.[19] The existence of this intended exclusionary effect does not invalidate the regulations. See *Bowles* v. *Willingham*, 321 U.S. 503, 518; *Mulford* v. *Smith*, 307 U.S. 38. "Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end." *Federal Housing Administration* v. *The Darlington, Inc.*, 358 U.S. 84, 91.

In drafting the regulations the Commission gave due consideration to the competitive implications of its interim regulations, as required by Section 15 of

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which were drawn with the segregation rule in mind—as a reason why there should be no segregation rule.

[19] Recently two option firms filed petitions under the Bankruptcy Act, leaving their customers without any meaningful prospect for payment. One of those firms, which had not segregated customer funds, listed liabilities of $689,000 to 118 customers who had exercised their profitable options but could not be paid, and it also identified 217 customers holding unexpired options with respect to which the firm's liability is undetermined. Petition for Bankruptcy dated June 20, 1977, *In the Matter of Sterling Industries, Inc.*, N.D. Ill., No. 77 B 4431; *In the Matter of Palmer Trading Company, Inc.*, E.D. Ill., Petition for Arrangement under Section 322 of Ch. XI, No. 77 B 5157. See also *In the Matter of J. S. Love & Associates Options, Ltd.*, S.D. N.Y., bankrupt No. 76 B 590, decided May 20, 1976.

the Act, 7 U.S.C. (Supp. V) 19. The Commission addressed public comments it had received concerning the competitive implications of the rules it was adopting (41 Fed. Reg. 51809), and it expressly discussed the competitive implications of the segregation requirement.[20] In light of the Commission's finding, the district court correctly rejected the petitioners' contention that the requirements of Section 15 had not been met (Pet. App. 24a); the court of appeals apparently considered the claim too insubstantial to require discussion. This decision turns on the facts of this case and does not require review here; it is fully consistent with the legislative history of the Act.[21]

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[20] The Commission stated (41 Fed. Reg. 51809):

> While the Commission is mindful that the financial, segregation and other criteria imposed as prerequisites to allowing a person to enter into or continue in the commodity options business may result in some lessening of competition, in its judgment, the interim rules are necessary to effectuate an essential purpose and policy of the Act: That is to require that the Commission provide essential customer protections which would attempt to assure the financial solvency of option transactions and prevent fraud. * * * [I]n weighing its responsibilities, the Commission has determined that the objectives, policies and purposes of the Act can be met, in its judgment, only by regulations such as these.
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> * * * * *
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> The Commission does not understand section 15 of the Act to require that the Commission permit entry into or maintenance of the commodity options business at the expense of the public interest considerations with which the Act is concerned.

[21] The Senate Committee Report made clear that Section 15 was being adopted at the suggestion of the Department of Justice in order to assure that the Commission would not uncritically adopt " 'an anticompetitive rule which was not necessary to achieve a valid regulatory objective.' " S. Rep. No. 93-1131, 93d Cong., 2d Sess. 22-23 (1974). Congress did not intend, however, to encourage "excessive litigation to test the decisions of the Commission to determine whether they represented the least anticompetitive means of achieving the objectives of the Act." *Id.* at 23. Congress therefore directed the Commission to "*endeavor* to take the least anticompetitive means" of achieving the statutory objectives (*ibid.*; emphasis added). The Conference Committee emphasized, in adopting this approach, that the requirements of Section 15 were "not intended to constitute any procedural roadblock to the Commission in regulating the futures trading industry." S. Conf. Rep. No. 93-1194, 93d Cong., 2d Sess. 35 (1974).

Petitioners also contend the segregation requirement will be ineffective to accomplish the Commission's stated purposes; they argue that a customer would have no claim to segregated funds in the event of an option firm's insolvency (Pet. No. 77-204, p. 26). The segregation rule is intended, however, to separate the customers' funds from the bankrupt's estate until all obligations to the customer have been fulfilled.[22] It is within the Commission's broad authority under Section 4c(b) to impose this condition upon option trading, and the courts should respect the legal relationships it establishes.

Moreover, under general equity principles applicable in bankruptcy, creditors of an option firm would

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[22] A trustee in bankruptcy succeeds to only the interest in property that the bankrupt possessed. *Zartman* v. *First National Bank*, 216 U.S. 134; *Hurley* v. *Atchison, Topeka & Santa Fe Ry.*, 213 U.S. 126; *York Manufacturing Co.* v. *Cassell*, 201 U.S. 344.

have no claim to the segregated funds, for their extensions of credit to the firm could not have been made in justifiable reliance upon such funds being part of the firm's assets. Courts that have had occasion to consider Section 4d(2) of the Act, upon which the segregation requirement is patterned, have recognized that a bankrupt futures commission merchant will be treated as a trustee of segregated customer funds. See *In the Matter of Weis Securities, Inc.*, CCH Comm. Fut. L. Rep. ¶ 20,108, decided October 23, 1975 (S.D. N.Y.); *Seligson* v. *New York Produce Exchange*, CCH Comm. Fut. L. Rep. ¶ 20,029, decided March 28, 1975 (S.D. N.Y.).

Petitioners' central assault upon the segregation requirement, however, rests upon the premise that customers are already adequately protected by guarantees of performance. Petitioners transact business with commodity option merchants in London. Petitioners argue that a system of guarantees and segregation of funds in London secures performance and makes further protections unnecessary.

The nature of the London options market, far from ensuring performance of obligations to the customer, in fact makes the Commission's segregation rules necessary. An American dealer places an order for an option with a clearing broker in London and transmits the necessary funds (which may be substantially less than the American dealer received from its customer). The clearing broker purchases the option through the London exchange from an option writer or grantor. The clearing broker does not, however, pay to the writer the full price of the

option; that payment goes into a separate account maintained by the exchange's clearing house and is part of the fund used by the clearing house to guarantee the performance of the option in the event the writer defaults. The option is registered in the name of the clearing broker, and it can be exercised only on the request of the American dealer.[23]

This system provides apparently effective guarantees that if any option should be exercised, the obligation will be kept even when the writer is unable or unwilling to do so. But because the option is not registered in the name of the American customer, the American dealer is an indispensible ingredient in the process of exercising any profitable option. The safeguards of the London system do nothing to ensure that the American dealer will properly perform its role. If the American dealer should be unable to transact business in a normal way and exercise options on the customer's request—because the dealer becomes bankrupt, for example—the American customer would be without practical recourse.[24] The London system would not refund his purchase price. The guarantee protects the London clearing broker from default by the option writer in the United King-

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[23] The London rules are discussed at J.A. A-150-A-152, A-435, A-583, A-745-A-746. ("J.A." refers to the joint appendix filed in the court of appeals, a copy of which has been lodged with the Clerk of this Court.)

[24] The American customer might persuade the dealer's trustee or agent to attempt to trace the option and protect the customer's interests, but the availability of such relief in individual cases is problematical.

dom, but it does nothing to protect a customer from difficulties experienced by his American broker.[25] Indeed, because the London exchanges will not register options in the customers' names, they prevent effective self-help by customers and make necessary the safeguards the segregation rule provides.

3. Petitioners in No. 77-96 contend (Pet. 15-17) that the Commission improperly required that all dealers in options cease doing business after January 17, 1977, unless they were registered with the Commission. Their contentions in this regard go not to the validity of the regulations on their face but to the propriety of the application of the regulations in the circumstances of their cases. Many dealers have properly registered, and petitioners' contentions should more appropriately be reviewed in any enforcement proceedings against them.[26]

In any event, the court of appeals correctly held that the registration requirements were not unfair (Pet. App. 46a-48a). Petitioners "did have reasonable advance notice that registration would be required and could not rely on the possible success of their lawsuit as an excuse for not being prepared to file" (*id.* at 47a). The Commission acted promptly on the applications; the major source of delay was the delay of petitioner British American in filing for registration (it did not file until December

[25] See Pet. App. 44a: "[C]ounsel for British American in effect conceded that the London guarantees do not run to options customers in the United States."

[26] Enforcement actions are pending. See note 8, *supra*.

29, 1976) and the various apparent violations of other regulations committed by petitioners.[27]

4. The rulemaking record does not support petitioners' contention that the challenged rules were adopted without adequate notice and public participation. The Commission adopted an antifraud rule applicable to options within the first few weeks of its existence.[28] In October 1975 the Commission announced that it was considering the adoption of the rules to regulate (or perhaps to forbid) transactions in commodity options; it also formed an Advisory Committee to study possible regulatory approaches. The Commission solicited public comment on the merits of various regulatory alternatives. 40 Fed. Reg. 49360.[29]

[27] See note 8, *supra*. A fully completed registration application of petitioner Lloyd, Carr & Co. was filed only on January 25, 1977, and was denied on August 1, 1977, in light of its apparent violations of substantive regulations of the Commission. The registration of petitioner British American initially was delayed by its late filing (December 29, 1976). British American continued to operate after January 17, 1977, without being registered, and it also has been charged with substantive violations, including violations of the anti-fraud rules. On September 7, 1977, it was enjoined from further operations; the Commission has been informed that British American has sold its assets and ceased doing business.

[28] 40 Fed. Reg. 26504.

[29] One of the alternatives suggested, 40 Fed. Reg. 49360-49361, was "forbid[ding] commodity option transactions by any person not registered as a futures commission merchant." The possible adoption of rules "concerning segregation of customer funds" and "to provide financial safeguards to the customers" was also mentioned. 40 Fed. Reg. 49361-49362.

The Commission published specific proposed regulations in February 1976; these contained, among other things, registration, recordkeeping, disclosure and minimum financial requirements. 41 Fed. Reg. 7774.[30] After public comment and oral hearings on these proposals, and upon consideration of the report of its Advisory Committee,[31] the Commission proposed a revised set of regulations on October 8, 1976, and solicited public comment once again. 41 Fed. Reg. 44560. The interim regulations adopted on November 22, 1976, were substantially the same as those published in October. 41 Fed. Reg. 51808. The court of appeals concluded (Pet. App. 41a) that "[f]airly characterized, * * * the Commission's procedures adequately complied with statutory requirements and did no substantial injustice to the" petitioners.

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[30] These proposals contained a minimum net capital rule that would have required option firms to have sufficient capital to cover all unrealized profits to customers on open option transactions. This rule would have made a segregation rule redundant. The Commission nonetheless solicited comment on the advisability of segregation. 41 Fed. Reg. 7776.

[31] The Advisory Committee was composed of 17 members. It included industry leaders, exchange officials, economists, attorneys, the Illinois Securities Commissioner, a farmer-rancher, a consumer representative, and two members of the Commission (one of whom served as the Committee's Chairman). The Committee reviewed the practices of commodity option firms in this country and those of the London exchanges. Its findings, conclusions and recommendations were published in a report submitted to the Commission on July 6, 1976 (J.A. A-78).

Petitioners contend that the Commission's procedures were deficient because, notwithstanding the provision in Section 4c(b) of the Act that option "regulation[s] may be made only after notice and opportunity for hearing," the Commission held no oral hearing after publication of the October 8, 1976, proposals. But this Court, in considering a similar statutory provision that certain rules be adopted only "after hearing," has held that this requirement does "not by its own force require the [Interstate Commerce] Commission either to hear oral testimony, to permit cross-examination of Commission witnesses, or to hear oral argument." *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 241. See also *United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 758.[32]

Moreover, because the notice and comment provision of "[t]he Administrative Procedure Act does not require that the rules adopted be identical to those proposed" (Pet. App. 22a),[33] the Commission's

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[32] Petitioners have not contended that a case like the present one should call for "hybrid" rulemaking like that required by the court of appeals in *Vermont Yankee Nuclear Power Corp.* v. *National Resources Defense Counsel, Inc.*, No. 76-419, certiorari granted, February 22, 1977. Because the Commission held an oral hearing before adopting the challenged regulations, the requirements of "hybrid" rulemaking would be met, and there is no need to hold this case pending this Court's decision in *Vermont Yankee*.

[33] *California Citizens Band Association, Inc.* v. *United States*, 375 F.2d 43, 48-49 (C.A. 9); accord, *Chrysler Corp.* v. *Department of Transportation*, 515 F.2d 1053, 1061 (C.A. 6);

solicitation on three different occasions of written public comment on proposed option regulations prior to adoption, as well as its holding of an oral hearing, provided ample public participation in the rulemaking process.[34]

South Terminal Corp. v. *Environmental Protection Agency*, 504 F.2d 646, 659 (C.A. 1); *International Harvester Co.* v. *Ruckelshaus*, 478 F.2d 615, 632 (C.A.D.C.).

[34] Petitioners' contention (Pet. No. 77-96, pp. 19-20) that the court of appeals was not entitled to accept the reasons stated by the Commission as "good cause" under 5 U.S.C. 553(d)(3) for having made certain provisions of the regulations effective less than 30 days following their adoption and publication is incorrect. Petitioners offered no evidence to place the Commission's rationale in dispute, and the court of appeals' position that the Commission's statement should be accepted is consistent with other decisions. See, *e.g.*, *California* v. *Simon*, 504 F.2d 430 (T.E.C.A.), certiorari denied *sub nom*, *California* v. *Sawhill*, 419 U.S. 1021; *Clay Broadcasting Corp. of Texas* v. *United States*, 464 F.2d 1313 (C.A. 5), reversed on other grounds, 415 U.S. 336; *Buckeye Cablevision, Inc.* v. *Federal Communications Commission*, 387 F.2d 220 (C.A.D.C.). Moreover, the segregation rule of which petitioners primarily complain did not become effective until 30 days after its adoption. See 41 Fed. Reg. 51817. In any event, this contention is moot; the failure of an agency to satisfy the "good cause" requirement for shortening the time when a regulation becomes effective does not render the regulation ineffective after the 30-day period has elapsed. It would affect the validity of the regulation only during the 30-day period, which lapsed on December 24, 1976. *Lewis-Mota* v. *Secretary of Labor*, 469 F.2d 478 (C.A. 2).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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